East Asia

JAPAN

CONSTRUCTION INDUSTRY CHANGES

FBIS-EAS-90-245-S *20 December 1990*

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912A0015A Tokyo NIKKEI BUSINESS in Japanese 24 Sep 90 pp 7-9—FOR OFFICIAL USE ONLY

[Text] "Perhaps there is the misunderstanding that builders are probably really making money hand over fist because it was trumpeted in the mass media as a luxurious government office building, but that's ridiculous. The profits are pretty slim." The president of company A, a leading general contractor, talks about a new construction project: a Tokyo municipal office building in Shinjuku scheduled to be completed in March of next year.

Even Luxurious Municipal Government Buildings Big Money Losers In Reality

Contracts for the giant sum of 90.5 billion yen were awarded for the First Municipal Government Building, the Second Municipal Government Building, and the Municipal Legislative Assembly Hall, municipal government office projects that have come under a barrage of criticism as a waste of tax money. That they were deficit orders received was "an open secret" in the industry.

In fact, the president of company B, a small-to-medium sized company in Tokyo that participated in the bidding, offers evidence. "For the First Municipal Government Building, 10 companies and two consortia, their eyes on the municipal government office building budget, bid at 47.4 billion yen. If the builders had an estimate, it was of a 10 billion yen deficit. Hastily, after winning the contract, they shrank the margin of deficit to 6 billion yen with design changes and cost-downing. Even so, it seems they really had the materials suppliers crying."

It is not only municipal government office buildings. Unprofitable projects for government and public agencies continue to emerge. Civil engineering works are not so bad, but building works are terrible to see. A senior official of company C, a second-tier leading general contractor, says: "Apart from materials costs and labor costs—in short, this company's operating expenses—on direct expenses alone we run over budget by an average 6.5 to 7 percent on the amount of the order received. The president of previously mentioned company B also reiterates that, "Last year and the year before last were particularly terrible. We paid an average of 15 percent out of pocket, 20 percent in bad cases." Public works, where one loses just by doing them: this is the common recognition in the construction industry.

When this happens, it is natural that a movement for keeping a respectful distance is beginning. A senior official of Company C, a second-tier leading company, speaks as if spitting out his words: "As a good business practice, don't take on any more public works. It might appear to be all right even if government offices don't turn a profit, but at a time of a labor shortage like now, we can't pour our valuable technicians into a deficit for welfare."

The "separation from officials" in the construction industry, which is supposed to be timid toward government contracts, has half come out into the open. It is truly a change from seven or eight years ago when an inhumane battle opened up, and companies beat each other over bidding prices in scrambling for construction projects.

If large enterprises carry a backlog of close to two years of private construction works orders, they can cover the red ink of government and public construction works with profits from private construction works. However, for regional general contractors, which depend to a high degree on government and public construction works, the important topic is how they will escape from government and public construction works.

"The penalty for suspending a designation is frightening. We just can't withdraw from bidding. Even speaking of fellow designated industry participants talking together, it is in the sense of, 'You do it.' ' No, you do it.' We all try to push it off on each other. We're doing a reverse *dango* to escape from receiving orders," according to Chairman Akio Suzuki of the National Association of Small and Medium Construction Companies.

When the companies have judged that their deficits have become extremely large, they will only submit bids higher than the provisional price of the government and public construction works. This is a failure to come to agreement on a bid; in reality, a withdrawal from bidding. President Moriji Toda of Toda Construction offers testimony: "Speaking from long experience, it takes a great deal of determination for people in the industry to end the bidding in a failure to come to an agreement. Once you do such a thing, you're viewed as uncooperative by government offices and can't receive work for three or even five years. Isn't it the case that, if a construction project runs over budget by about 10 percent, most people in the industry will do it while weeping?"

Skyrocketing Labor Costs Not Reflected

Naturally, if it is a single large project like a municipal government office building that comes along perhaps once in 10 years, one can write it off as something that cannot be helped. "That's because it has a symbolic element and will be noticed. Even if it goes into the red, we can say that there will still be some benefit. It's cheap if you think of it as a PR expense." The president of D company, a second-tier leading general contractor, takes a defiant attitude. The understanding, according to Tokyo Association of Small and Medium Construction Companies Chairman Akira Watanabe, is that, "There is meaning in participating. That is to say, one has to enter one's name in the construction industry's Olympics."

The capital's new government offices are exceptional The capital itself is being overtaken by a serious breakdown in the bidding. The four or five cases a year grew rapidly to 137 in 1988 and 157 in 1989. This trend is also spreading to local Home Affairs construction projects.

In 1989, there occurred 17 cases of bidding breakdowns in Saitama Prefecture and 11 cases in Ibaraki Prefecture. In both prefectures, there had been almost no bidding breakdowns until that time. It is not only the Kanto district. In Kyushu, where there had been no such problems, the Kyushu Regional Construction Bureau, which had sensed a change, hurriedly began this year a survey of actual conditions. What led to this change which spread like wildfire in government and public construction projects is the sudden price increase for labor due to the labor shortage. The basic unit price—used in the "estimate" of the provisional price that government and public offices work out—and the effective unit price are extremely far apart. "For example, a carpenter's wages for a day's labor is not expected to reach 20,000 yen according to the estimate. In reality, I'm paying out around 32,000 to 33,000 yen," according to the president of company E, a mid-sized general contractor.

Why does this kind of thing happen? The estimated unit price is decided based upon a labor cost survey of the Ministry of Construction (MOC). The MOC surveys the capital and each prefecture separately each October, then includes the results into the labor costs revision for the next year. In short, it is a structure in which the survey results are reflected half a year later at the earliest and over a year at the latest.

Because wage hikes and inflation rates are considered seriously, there is no problem if it is a time when labor costs are stable. However, in the case of a sudden jump in costs, as in these past two or three years, the estimtaed unit prices cannot catch up with the effecive unit prices. Moreover, in line with accounting laws, government offices cannot place orders at prices that surpass the provisional price, so successful bidders inevitably end up in the red. Let us take as an example the wages in Tokyo, where the labor shortage is especially sever, for those who erect the iron rods and pour the cement. The average surveyed rate of increase from 1982 to 1986 was 2.1 percent and 1.5 percent [respectively]. Then from 1986 to 1989, they rose by 8.2 percent and 10.4 percent respectively. The pace of wage hikes is constantly on the rise.

"We Can Live Fully on Private Demand Alone"

"I got the job, but the trouble is the work is running behind schedule because there aren't enough workers on the site. If there aren't enough, I'll get them by paying out 1,000 yen more than other places. I'll bring back those taken away by telling them I'll pay 500 yen more," according to Nishimatsu Construction President Taira Shibata. This kind of battle to acquire laborers is unfolding. The result is that the companies fall into a vicious cycle, hanging themselves with rapidly rising labor wages.

The increase in construction demand accompanying the domestic demand expansion is the cause that invites this kind of imbalance. Private construction investment such as in offices and factories in particular has risen sharply.

Japan's construction investment figure recorded negative growth nominally for the first time in the postwar era in 1982. Much was made of the "construction industry's winter period." However, the industry made a comeback from 1983's low of 47.6 trillion yen to a level of the high-growth period of the 1960's and early 1970's, reaching 72.95 trillion yen in 1989. With the prospect of hitting 77.13 trillion yen in 1990, the sense is that the industry has at a stroke broken through to a hot summer in which demand is burning fiercely.

The percentage the private [projects] occupies in construction investment has grown sharply. The private construction investment ratio of 58.2 percent in 1983 increased by 7.5 points to 65.7 percent in 1989. Looking at the 54 large companies of the Japan Federation of Construction Contractors (Nikkenren), the ratio is 74.7 percent. The industry's real thinking is, "Because private construction projects keep us busy, we do not want to knock ourselves out and take public construction projects that are unprofitable, if for no other reason than because of the labor shortage. It is, "Hello, private projects; goodbye, government offices."

It appears that this situation will continue for the time being. Nikkenren Chairman Hajime Sako (chairman of Taisei Construction) speaks: "Although there is concern in such areas as the situation in the Middle East, large-scale projects such as resorts, industrial estates, and urban research parks are waiting for us in each region of the country. There'll be no sharp fall."

Against a background of U.S. pressure, the Japanese Government's announcement of "a total public works investment of 430 trillion yen in the next 10 years" is a tail wind for the industry. Even if private demand cools, the industry can be supported by public works. Thus, according to Associated General Contractors of Japan Chairman Shin Fujita and others, "At a minimum, we're not turning back to the winter period yet."

Construction is now a seller's market. What truly expresses this is the rapid increase in after-tax profits of each company. In the case of Ohbayashi Gumi, for example, profits in 1989 doubled those of the previous year. A major reason is the wholesale drop in the effective tax rate due to the sharp fall in social expenses.

When speaking of the construction industry, it is common knowledge that the companies pour money into entertaining the "honorable benefactors," i.e. those who tender the orders. However, "in the past this would never have been considered, but recently it has been fine if the customer were only received once. For that reason,

social expenses have dropped considerably," according to Toda Construction Vice President Tetsuo Mizuno. It is not even rare for the president of a company listed on the first section of the Tokyo Stock Exchange to come with his head bowed.

Far From the Three K's, It's the Seven K's Now

However, the reverse side to the bullish conditions is that the construction industry's image is growing worse all the time. Chairman Suzuki of the National Association of Small and Medium Construction Contractors laments: "It's not only the capital area. Even in more remote areas we don't get the young laborers to work at the sites." It is ironic that construction is said to have become the representative Three K industry—kitsui (hard), kitanai (dirty), and kiken (dangerous)—kept at a distance just as it left behind its winter period. Now, including "kurai (dark), kakko-warui (unfashionable), kyujitsu-ga-sukunai (few vacation days), and kyuro-ga-yasui (low wages)," it is even being ridiculed as the 7K [industry].

In this way, strengthened by the sense of crisis that the industry will be abandoned by the young, each company is working desperately to raise its image. The entire construction industry's summer bonus this year rose 18.6 percent over the amount last year, the highest gain among all industries. Twelve companies such as Nishimatsu Construction and Tobishima Construction surpassed the 1-million yen level. Attempting by fits and starts to bring its long working hours close on a par with other industries, the leading members of Nikkenren will introduce a system of two days off per week starting in April of next year.

There is also a boom in CI (corporate image). From last year, Shimizu Corporation, Taisei Construction, Ohbayashi Gumi, and others all began such CI activities as creating corporate logos.

Added to the pressure from within of the labor shortage, external pressure has also risen. Since the Japan-U.S. agreement of May 1988 related to construction friction, government-to-government negotiations have been held on opening the construction market. But the concern is that, far from meeting U.S. criticism, they appear to strengthen it.

This series of events appears to be breaking through the roots of the construction industry's practices and its foundation from since the Meiji era. Now, amidst unprecedented bullish activity, earth-shattering changes have begun.

* Small, Large Firms Labor Division

912A0015B Tokyo NIKKEI BUSINESS in Japanese 24 Sep 90 pp 10-15—FOR OFFICIAL USE ONLY

[Excerpts] A five-minute walk from the Higashi-Nagasaki station on Tokyo's Seibu-Ikebukuro line. Just one year earlier, a 3-story building was completed. It is not a building worth a second glance, but there is a reason why it became a topic of conversation in the construction industry. The firm that put up the mini-building was actually Ohbayashi Gumi, ranked fifth in the construction industry in sales in 1989.

Chairman Akira Watanabe of the Tokyo Association of Small and Medium Construction Contractors speaks with a look of fatigue.

"I heard that building was put up by Mr. Ohbayashi, but I thought that it couldn't be true since that's such a small building. But walking past it, I saw that Ohbayashi Gumi was really written on the signboard. I was surprised."

There is an unwritten law in the industry that the leading companies do not muscle in on the petty construction projects that the small and medium companies handle. No, one should probably say precisely that there was. Around 1983, the time of the "construction industry's winter period," there was an extreme reduction in work. An inhumane battle was played out between a jumble of the large, medium, and small companies. Along with the later recovery in demand, the rules to divide the shares of work had been observed apart from very few exceptions. However, recently, territorial incursions have again become rampant.

Ohbayashi Gumi's 1990 orders broke through the 2 trillion yen barrier. It is seen as certain that Kajima Construction—in second place in the industry in terms of sales—and third-place Taisei Construction will reach the 2 trillion yen level.

Shimizu Construction, Which Hooked "Small Mouths," Now No. 1

Shimizu Construction, the largest player in the industry, quickly reached 2 trillion yen in orders in 1989. In the rankings for orders, Shimizu Construction has occupied the top seat since 1987, but jumped to first place in sales and operating profits as well in 1989. Having become tops in the three sectors, the company suddenly was in the limelight as the "triple-crowned king of the construction industry."

With Shimizu's 1989 sales of 1.4766 trillion yen, a rise of 17.7 percent over the previous period, the company had a 56.8 billion yen lead over second-ranked Kajima Construction. With 2.282 trillion yen in orders, a 24.5 percent increase over the previous period, Shimizu established a lead of 99.3 billion yen.

The distinguished Kajima Construction took second place to Shimizu in all three sectors. Concerning sales and orders, Shimizu Construction's superiority had continued from before, but Kajima Construction was on top in relation to profitability. Occupying the top in three consecutive periods from 1986 (not counting 1987's irregular accounting due to changes in the accounting period), particularly in 1988 when it established a lead of close to 10 billion yen over Shimizu. Because it is an

industry that is particular about industry rankings, rival enterprises investigated the secret of Shimizu Construction's leap.

Shimizu picks up petty construction projects that the leading companies until then had not even bothered to look at. In a word, this is the driving force behind the triple-crowned king's leap. President Akira Miyazaki of Kajima Construction analyzes: "We are able to establish a lead of about 100 billion yen over Shimizu with construction projects under 1 billion yen. I'd like to say that we were able to establish a lead by actively taking orders on petty construction projects."

Director Mitsuhiro Kishimoto, present deputy director of Kajima Construction's business headquarters, sticks out his chest: "We've traditionally had a structure which responded quickly. Construction projects of under 1 billion yen surpass 50 percent of sales. I think we are number one in this percentage among the leading companies."

Certainly, Shimizu Construction's business unit has a reputation for quick footwork. One of the secrets is decisively throwing young businessmen onto the front line. Throwing even newcomers to the company onto the first line of the work tempers them thoroughly with on-the-job training. There are many cases of succeeding in developing new clients hurriedly.

Roused by the new employees, the veterans also must take the challenge for new developments. They are actively broadening their field to pachinko parlors and such areas where the leading companies have not gone.

The pachinko industry, with its over 15,000 parlors nationally, is estimated to have a yearly turnover of roughly 13 trillion yen. The parlors are on first-rate land in front of railway stations and such. With the take-off in land prices, the value of their assets is rising sharply; there is a strong appetite for capital investment. Shimizu Construction does not overlook this growth area.

According to the construction office presidents in the cities who handle broadly the layout and management of the pachinko parlors, Shimizu Construction won four or five bids on the pachinko parlor construction projects that these offices set out on. Particularly enthusiastic in the districts of western Japan, the directors of Shimizu Construction's branch offices are inviting pachinko owners to go golfing. [passage omitted]

Concerning the background to Shimizu Construction's having become the triple-crown king, Mr. Makoto Kaimasu of Nomura Research Institute's corporate research division (chief of the research office on the public infrastructure industry) says that, "The key words are Tokyo, private, and construction." "Tokyo" is the capital area centered and it is here that Shimizu Construction has had its business base. As this region witnessed a rush of redevelopment projects, the commercial value of the land has risen over the past several years due to the jump in land prices. With buildings appropriate to the high-sum asset's land, the change to large scale and high class in construction buildings advanced rapidly.

Shimizu Construction has traditionally been strong in the field of private construction. From small projects to large, the company has a highly developed know-how in various buildings. Consequently, in building headquarters buildings, cases have increased sharply of companies placing special orders with Shimizu, well known for its building achievements and, moreover, with the power of its name. In the competition with other companies to take "special assignments" referred by clients, the profit rate is high because there is no need to haggle over the price.

Kajima Construction, Which Has Many Special Orders

The strength of the major players, with Shimizu Construction as typical, is being able to gain excellent, high-income construction projects with special orders. Looking at 1989 building, the leading companies' special order ratios are: Shimizu Construction, 81.2 percent; Kajima Construction, 88.0 percent; and Taisei Construction, 72.2 percent. The rates have risen by 4 to 9 points in the last two years. Those who are fully basking in the benefits of the building boom this time are the so-called first-class "super leading companies." The rise during these past four or five years in the orders received and sales of each company has been tremendous. For example, the total figure for orders received by the top three companies in 1989 was 5.8 trillion yen, a 24 percent increase compared to a year earlier. The scale of sales of the top three companies over the past five years roughly quintupled. The leading companies' share of orders received occupying the construction total expands more and more; it already occupies close to 30 percent.

However, speaking of whether all the major players are singing the praises of high-speed growth and high income, that is not the case. Rather, in the midst of this boom, the gap in earning power even between the leading companies is becoming remarkable.

The situation is clear in the 1989 accounts. Dividing the 54 member companies of Nikkenren into groups by the scale of turnover, looking at the rate of increase of finished construction projects total profits, the rate of increase of the six companies whose average turnover was above 800 billion yen during the past five years was a high one of 27.1 percent. In contrast, the 10 companies whose turnover was in the 300-800 billion yen class had a rise of 19.3 percent. Furthermore, those seven companies in the 200-300 billion yen class had a single-digit rise of 7.1 percent. As a whole, although sales are rising, a gap related to income is becoming clear.

Generally speaking, the drop in the profit rate of the mid-sized class of enterprises, among them those that concentrate on civil engineering, is remarkable. When it comes to the super leading companies such as Shimizu Construction and Taisei Construction, their ratio of civil engineering is around 20 percent lower. The companies that on the contrary are highly weighted toward civil

engineering are not able to ride out the present construction boom. For example, Daiko Construction, for which civil engineering accounts for 70 percent of sales, is stagnating with an average ratio of increase during the past five years of less than 1.1 percent. There is also the problem of unprofitable overseas construction projects, but the shift from civil engineering to building not progressing as anticipated is a large part of it.

Every civil engineering-type general contractor is making efforts to receive building orders in a bid to ride the private building boom. However, profitability is worsening because if they try to develop new clients, they do so even if it hurts in terms of profits.

When they are no match for the leading companies in quantity of orders received, a strategy to brings into focus and make clear distinctions with the leading companies becomes indispensable for construction industry participants that are second-tier leading companies and below.

On that point, the example of Fujita Kogyo, which early on raised "manufactured orders" and has made efforts in its real estate development department, is a reference.

Sales of Fujita's real estate development department, totaling 156 billion yen in 1989, grew to account for one-fourth of total sales. Real estate development work sticks out from the traditional construction business framework of receiving work orders from clients. It is a strategic business, the acquisition of real estate and the laying of plans for building projects—that is to say that which has to do with the corporate planning stage before the order is tendered.

Fujita Kogyo, Which Takes the Lead in "Manufactured Orders"

In taking the lead oneself to devise a building plan is to take on the position of the one who tenders an order. The risks are high. On the other hand, if one is successful, the profit ratio is also high. It is called "manufactured orders" in the sense that one creates the demand oneself. At present, every general contractor is making an effort in that area, but Fujita Kogyo stays one step ahead.

With favorable conditions in its development department as well, Fujita Kogyo's 1989 rate of increase in turnover was 23.4 percent, far above the 14.3 percent average for the listed construction enterprises. The turnover operating profits of 6.63 percent are also above the industry average by more than 2 points.

Business Development Headquarters Director Yoshiharu Ide speaks of the circumstances in which Fujita Kogyo made an effort in its real estate development department: "In contractor-type operations, we were bullied by the top-ranked [companies] and put under pressure from below. The result was that we decided that we wouldn't be able to grow simply by going after quantity."

One cannot necessarily call it a policy of desperation after having been cornered, but there were reasons beyond that why Fujita Kogyo had to make an effort in the real estate development business.

From the mid-1960's to the mid-1970's, the company actively moved ahead in such areas as leisure development. In reaction to the oil shock, the group was saddled with 100 billion yen worth of land. But with the spectacular rise in land prices, the burden turned into a gold mine.

Of course, the company could not prevail by landholdings alone. Searching for suitable land for development, the company established, apart from its branch stores in the capital area, 88 "bases." In reality, while having its company employees live there, it absorbed development information such as tax discussions for inheritance. The company is developing a "complete operation type business."

Recently, there have been many large-scale, profitable building projects. The gross profit rate has risen, but even so it is around 8 percent. In contrast, the finished construction projects total profit rate surpasses 20 percent in the real estate development business.

Of course, it is not the case that there are no problems in the development business. One is that it takes time. Depending on the circumstances, projects that take over 10 years are not rare. If the planning becomes deadlocked along the way, a company's hard work comes to nothing.

Furthermore, to continue on this road, it is necessary to acquire new land for the purposes of development enterprises. Large sums of funds are required for these acquisitions. In Fujita's case, the company held over 500 billion yen in land at the end of 1989, but the money borrowed for the short and long-term together reached approximately 240 billion yen.

Manufactured orders based on real estate development are enjoying something of a boom among regional members of the construction industry. The over-the-counter enterprise Kabutodekomu, headquartered in Sapporo, is one enterprise making an effort in this business.

The company's 1989 sales were 41.85 billion yen and its operating profits were 7.183 billion yen, tremendous results respectively 2.7 and 5 times those of the previous period. An energetic real estate business is emerging against a background of rapid growth.

President Shigeru Sato attempts to draw a line with an industry preoccupied with taking orders: "If you're too wrapped up in competing for orders, you come to take projects even at a deficit." As for the company's method of entrusting all its orders received to specialized subcontractors, it is looked coldly upon by people involved in the industry, but President Sato does not worry about it.

Technical power is necessary for a discriminating strategy that includes "manufactured orders." The companies that have realized this have all run to strengthen their research structures.

Tobishima Construction Considers "Survival"

In 1989, the research and development spending of the five major players without exception crossed the 10 billion yen barrier for the first time. Kajima held the lead with 14.7 billion yen, Shimizu Construction had 14.7 billion yen, Takenaka Komuten had 12.3 billion yen, and so on. Their figures were a match for those of fair-sized manufacturers. In 1988, Kumagai Gumi constructed a Tsukuba research laboratory equipped with an artificial meteorological room. Furthermore, the civil engineering-type, second-tier leading companies' exhibiting energetic movements is remarkable. Tobishima Construction opened a technology research laboratory in 1987. Also, Hazama Gumi last year set about expanding and moving its research laboratory to Tsukuba.

"The Nikkenren Research Center." The Nikkenren Central Technology Research Center is a research and testing facility on which work will be started in a corner of Chiba New Town within the year.

The start of the central technology research center was October 1987. The center is the research institute that 48 of the 134 mid-sized general contractors that are members of Nikkenren established with joint financing. Building a base in the Tokyo Minato district's Minato-Minami, they have advanced research primarily in the soft areas. Searching for a new world in Chiba, they have tackled in earnest the hard aspects of research. Chairman Rokuro Ishizawa of Nitto Construction explains the reason for the establishment of the joint research institute: "The gap between us in the mid-sized class and the major players are too large not only in the quantity of orders received but in research spending as well."

In contrast, the super-leading companies class is showing an expression of calm and compusure. President Yasuo Satomi of Taisei Construction speaks: "This company has a 30-year history in technology research institutes. At an accumulated investment figure of 100 billion yen, it won't be effective. There is a clear difference in the research investment sum between the leading companies and those under them." President Toichi Takenaka of Takenaka Komuten also shows his pride: "Achievements and technical power are key in private orders." In past achievements, money power, and technical power, the gap is unmistakeable between the leading companies and those enterprises below them. There is a great possibility that oligopolization by the top general contractors will grow stronger.

President Takao Tsumuro of Ohbayashi Gumi speaks thus of the prospects: "The breadth of work in the construction industry isn't simply building boxes. It's moving toward complete proposals. The soft power of how to gather different types of information and put them together is becoming important. If the present situation continues, will the gap with the second-tier leading companies close? The trend is that it probably will not."

President Satomi of Taisei Construction is of the same view: "When the construction industry was just acting as a subcontractor, the effort ended with asking for work. Now everything, including the proposals and the attendant technology, plans—and the company's credibility, money and personnel—will decide the outcome."

President Akira Tobishima of Tobishima Construction, an established civil engineering firm now content to be a seond-tier leading company, says that, "Competing for quantity of orders received, you say? We can no longer catch up with the leading companies, such a gap has opened up. What we should now consider, rather than stretching to expand the quantity of orders received, is how to survive. Putting forth our special qualities as a company is important."

Even if the company did take a hit in the Fujita Kanko share price manipulation incident by Koshin's representative, Mitsuhiro Kotani, there is not necessarily a feeling that President Tobishima's expression of "surviving" in an unprecedented boom is, more or less, welcomed.

Tobishima's 1989 turnover was 416.4 billion yen, an increase of 9.2 percent compared to the previous year. Sales are rising with the tail wind of the boom. But the reality is that "the management topic of 20 years" of expanded participation in the private building sector is runnng into the wall of leading companies, and the company is being compelled to fight a desperate battle. "The leading companies are carrying more more good clients by far than we are. They absolutely will not part with profitable clients. We are still heavily weighted toward civil engineering. If we try to get into private building, it will require a tremendous business effort," says President Tobishima.

Mid-Sized Firms Eyeing Restructuring?

There are also examples of corporations having strengthened their operations through mergers. There is Toda Construction, which merged with the mid-sized Shimato Construction in 1987. Mitsubishi Bank was pushing for the union, but it was perfect timing for Toda Construction. Just before the arrival of the unprecedented construction investment boom this time, Toda Construction upped its ability to take orders with the addition of Shimato's 300 technicians, which ties into its later leap.

In trying to compete simply in quantity of orders received, a company ends only in exhausting its strength. There is no guarantee that companies with no special character will be able to survive even amidst the boom. President Tobishima's sense of crisis comes from that.

What can be seen in looking at where the present boom will end up is a restructuring of the industry turning on the mid-sized enterprises. For this industry, which has a

strong family coloring to it, the view is strong that mergers are difficult. But there is the possibility that this movement will come to the surface at a stroke if the principles of competition are brought in due to foreign pressure, etc. Tokyo University Advanced Science & Technology Research Center Visiting Assistant Professor Fumio Hasegawa, who is knowledgeable in the industry's trends, speaks: "Recently, two or three such examples have emerged. Isn't it that a restructuring movement will emerge hereafter in the form of M&A (mergers and acquisitions)?" In any event, it is certain that the old industrial order and the logic of divvying up is not succeeding.

[Box, p 14] Sako Hajime, Nikkenren Chairman: "I would like to pursue just profits in a fair manner."

One can understand the thinking of a just distribution seen in the system of tendering orders in public construction projects if one considers the role it plays in nurturing small and large enterprises, preserving the employment strength in each region, etc. But, when the number of industry participants grows as it does at present, the goal of raising the technological level of small and medium enterprises becomes of secondary importance. How to divide the work between the industry particpants is given priority. The result takes the odd form of dividing the work finely and placing orders with any company as in the form of a present-day corporate commune. The gap in technological strength between the industry particpants receiving orders is excessive. There are many cases where there is no advantage on either side. I have requested of government offices on other occasions that I would like them somehow to revise this point.

Certainly, the viewpoint of protecting the small and medium enterprises is also indispensable. But the construction industry is a risky one, so the necessity of heigtening internal reserves and building a structure able to ride out the waves in good times and bad cannot be forgotten. For that, I would like to be able to pursue just profits in a fair manner. The power of those tendering the orders has been strong until now, and we have not been able to have negotiations on equal terms. We have not been able to do that which is a matter of course.

Even saying that we are making profits in favorable business conditions, the operating profit ratio even for the class of leading cmpanies is just at the level of 4 percent. It is only one percent higher than at the time called the winter period. There are many points we should correct even on our side.

[Box, pp 14-15] Mitsuo Suzuki, Chairman of the National Association of Small & Medium Construction Contractors: "I cannot be pleased with the increase in public works projects in the present fashion."

Whether it is the labor shortage problem or that of the antimonopoloy law, there is nothing but trouble for the small and medium industry participants. Young laborers don't gather together, so it is necessary to raise wages and introduce a system of two days off a week to improve the employment environment. However, because it is a system of day wages, there are many headaches such as how to guarantee wages for days off.

The below profit cost of public works projects these past two or three years has been terrible. When colleagues get together, there's nothing but talk of, "That construction project, did you make a profit?" In short, it's whether it ended with no losses. If the government offices do not seriously examine the revision of the estimated unit price and the equalization of orders placed, we are in for hard times. Therefore, even if public works investment is increased, it isn't a matter of making us happy. That it increases is fine, but on the other hand there are more vexing problems than that alone. As for the point of keeping laborers, we would be grateful if we had the present private demand cool off somewhat.

Concerning the issue of large-scale construction projects, I think that even general competitive bidding is all right. But, if it comes to competitive bids for small-scale construction projects that small and medium industry participants do, it is not only us who will suffer but the government offices as well. As for the strengthening of the antimonopoly law, if it comes to even the exchange of information as "forbidden," as expressed in the guidelines, the small and medium industry members—particularly the small-scale ones—will fall upon hard times.

* Business Practices Criticized

912A0015C Tokyo NIKKEI BUSINESS in Japanese 24 Sep 90 pp 16-22—FOR OFFICIAL USE ONLY

[Excerpts] 25 July—The construction industry's seven major organizations such as Nikkenren that make up the Construction Industry Reform Investigation Committee (Shimizu Chairman Teruzo Yoshino, committee chairman) presented to the Ministry of Construction (MOC) "A List of Demands Related to the Present State of the Bidding and Contract System Responsive to a New Era."

The main contents were reform proposals in 8 subjects related to tendering orders for public works: improvement of the competitive nomination bidding system, application of private contracts, revision of the form of joint ventures, etc. In other words, it is the construction industry's version of the [MOC's] "White Paper on Construction."

For the construction industry, whose cohesiveness is poor and which posses a strong posture of waiting for orders from above, to put out a list of demands to the authorities for changes to the system is itself unheard of. The MOC, accepting the report, has established a round-table discussion mixing industry members and those with academic experience and plans to open the first meeting on 26 September.

Chairman Yoshino, seen as the leader of the industry's reform faction, speaks with a feeling of satisfaction:

"The MOC didn't simply take the position of keeping it in mind. They are extremely positive toward our proposal. Nor are they the only ones to speak out. Well, it has become 'Let's have a roundtable discussion and do it together.' There has never been such a thing until now."

"Construction White Paper" That Large Companies Pushed

The interindustry organization, commonly called the "Yoshino Committee," started in February of last year. Since then, it has piled up investigations into instructional activities to prevent *dango*, surveys of foreign conditions, and the nature of the bidding system. In line with inviting lecturers from the Fair Trade Committee and opening explanation meetings in every region to provide a thorough knowledge of the antimonopoly law, the committee has sent survey teams to Europe and the United States. On 20 June of this year, at Nikkenren's standing board of directors, the committee again agreed to observe the antimonopoly law. The group again agreed upon its policy: "We exclude hereafter, of course, activities in violation of the antimonopoly law and all corporate activities which might invite suspicion of such."

It goes without saying that U.S. criticism of *dango* became the occasion for a series of reforms. Following the unearthing by the Japan Fair Trade Commission (JFTC) of *dango* on the U.S. military's Yokosuka base construction work at the end of 1988, an illicit cartel incident was discovered last fall in the Kansai's new airport construction works' earth moving. In the June structural talks [Structural Impediments Initiative talks] as well, construction *dango* were made a suitable target as a symbol, along with the Large-Scale Retail Store Law of the Japanese market's closed character and its unfair, exclusive trading practices. The words "general contractor" and "*dango*" are now established as English words made in Japan among those connected to the U.S. Congress.

Amidst the rise of this criticism, the friendship organizations viewed by many with suspicion as *dango* organizations managing in the shadows the management of bids from the society—set out to dissolve themselves, one after the other, from the beginning of this year. The Management Committee, comprising approximately 30 major companies, will break up on 18 June. The 99-member "Management Discussion Association" broke up at the end of June.

"At any rate, the United States says it's bad, so there's nothing we can do about it. That's because we are suspected unjustly." This explains the reason for breaking up the friendship organizations as reported by a senior official of a major general construction company who attended the "Wednesday Club"—comprising those responsible for the building departments for each leading company. It is in the form of giving in to the pressure of U.S. "*dango* containment," but there is no mistake that it is an expression of the industry's strong sense of crisis toward the reforms coming in quick succession.

After the Yokosuka base incident, the response of the industry led by Nikkenren's leading general contractors was quick. In the compilation of the "Construction White Paper" for the MOC, too, they seemed to seal off differing arguments within the industry and half strong-armed it through. "It's not that we're opposed to reform itself, but because it is a vital matter concerning the entire construction industry, it would have been good if we had taken a little more time to continue. That's becuase the leading companies in this industry are powerful, you know," according to the president of a mid-sized construction company in Tokyo. Such discontent is smoldering.

Naturally, Chairman Yoshino, who thought that it would be a problem if differing arguments burst forth afterwards, checked again and again: "We'll go with this. That's all right, isn't it?"

However, what one cannot overlook is the point that reform of the bidding system—cutting off the old practices and entanglements—is also a chance for the leading companies to expand their base of operations. Rather, there is also glimpsed the thinking of leading companies that would like to use foreign pressure as an opportunity to cut away and discard the pre-modern structure of the construction industry.

In fact, if the general competitive bidding restricted in large-scale construction works prescribed in the "Construction White Paper" and the free contract format were expanded, it is quite clear that the leading companies, with their technology and capital power, would generally dominate the field. Moreover, if the coordinating activities that invite suspicions of *dango* are absolutely forbidden hereafter, "The ones who will have the most trouble will be the regional small-to-medium as well as small-scale industry members who feed on public works," according to National Association of Small & Medium Construction Contractors Chairman Mitsuo Suzuki.

To say it the opposite way, the present system of placing orders, premised on "a just distribution," shackles the leading companies. Public works projects of 430 trillion yen in the next 10 years have been decided, but there are few advantages in the present system. In the background of hurried reform, there is probably no mistake that one can see hidden the leading companies' careful plans for the future.

In the midst of internationalization, Japan's construction industry is greeting a major transition period. How will the roots that have supported the industry's makeup and structure change hereafter? This point is truly the essence of the problem posed in the reform of the bidding system.

Low Productivity of "Construction Superpower"

The construction investment figure accounts for close to 20 percent of GNP. At 5.78 million construction workers, just under 10 percent of the total industrial population, it is plainly a basic industry. The U.S. investment figure in 1988 was approximately 52 trillion yen. Japan, at close to 80 trillion yen, the largest in the world, is truly a "construction superpower." However, the *dango* problem reveals that the orders often ignore profits, etc., and "Japan's construction industry is still dragging along its pre-modern structure," according to National Association of Construction Contractors Shin Fujita. Although some leading companies are tackling rationalization with the robotization of construction work, etc., total labor productivity is hardly rising at all. Taking 1980 as 100, manufacturing industries raised productivity to 156 by 1988. In contrast, the construction industry is almost flat at 105.

The number of authorized construction industry participants at present is 520,000 companies nationwide, but as many as 99 percent of them are small-to-medium and small-scale industry participants capitalized at less than 100 million yen. Even throughout the winter period around 1983, the number of industry participants hardly fell. To put it in extreme terms, that's because entry is as easy as hanging out a shingle. But another major reason is in the point that the principles of competition hardly work and dismissals for consolidation are not progressing. Here is where various contradictions are accumulated.

For example, if improvements are necessary, a typical example would be the joint venture (JV) format as prescribed in the "Construction White Paper."

The JV format designates multiple industry participants for a single construction project. It is a way of dividing the various shares received and orders tendered. Orders tendered according to this format increased since 1976. Already, by 1988 it accounted for over 30 percent of the total public works.

Mutual Support With Finely Divided Orders

Dissatisfaction with this JV format is building up among the leading companies. Small construction projects that can simply be done by one company alone are divided up among 5 or even 10. Moreover, those who tender the orders appoint all the partners who will band together. The enterprise which bears the responsibility for the entire project must provide an over-abundance of people.

In the event a construction project effectively goes into the red, the contractors must accept the red ink in proportion to their share of the project. This is a pretense, however, and there are not a few cases in which the leading company takes responsibility for the small and medium industry participants' red ink. Expenses in this area mount. There are even leading companies that have experienced receiving the tax office's recommendation to improve with their management strategy.

Whether subcontractor or fellow *keiretsu* corporation, others gather around and try to participate in the shares at no risk to themselves. This kind of practice in ignoring economic principles is nothing but the industry pushing their way.

The original meaning of the JV format was the "just distribution" of public works and the technical upgrading of small and medium industry participants. However, it soon became a dead letter, and the tendancy grew stronger for participating in the shares in name only. "This trend has also made its way into other industries. There is the aspect that it can't be helped because it's Japan's beautiful custom of harmony. Even so, the construction industry goes overboard. At this rate, the total level will never rise," according to Nikkenren Chairman Hajime Sako. That is certain.

It is not limited to the JV system. Even for single-order construction works, for example in the case of the MOC's upkeep department, the order money is from 160-300 million yen. Chairman Rokuro Ishizawa of the Japan Association of Construction Operators grumbles that, "In any event, they're holding the sums for orders tendered too small. The smaller the order the higher the costs of fulfilling it. I would like the total figure to be a little higher." Far from driving costs down, the system appears to be encouraging costs to rise. At the roots of such a finely divided system is the coexistence, coprosperity spirit of dividing widely and shallowly the work so that everyone will be able to eat.

At heart, the character of the construction industry as an employment regulating industry was strong, as seen in the public works orders tendered in slack times. One can say that Japan's construction industry is a system of relief for the latent unemployed to prevent the common ruin of industry participants by dividing orders tendered. In this we see the coddling and mutual support in trying for shares at no risk; structural improvement is retarded and does not move ahead. The MOC, while waving the banner of the industry's stuctural reform, has fallen into its own trap with its long-standing practice of pushing on the industry "a fair distribution."

Real Feeling That "Foreign Pressure Isn't a Big Deal"

However, it is not a matter of solving everything by simply tinkering with the system and its structure. A senior official of the Japan Civil Engineering Association relates the following: "In all honesty, we don't think even now that *dango* is all that bad. They said we were making arrangements beforehand, but it's not a matter of conducting cartel activities to raise prices unfairly. First of all, that's because we are constrained by the provisional price and can't do it."

Tobishima President Akira Tobishima states: "The United States is making an issue of it, but I have the feeling that it's a little different from the *dango* that we

Japanese know." If the way to the goal of a price cartel is in domination of the market by a small number, *dango*, with arrangements so as not to favor any specific industry participants, is truly the reverse. "Rather, *dango* is now working to prevent oligopolization, but if this were abolished, the shares would without a doubt be concentrated among specific industry participants," according to President Tobishima.

"In short, the United States demand is: 'You guys alone doing *dango* is unpardonable. Cut us a share, too.' Market opening is for their needs, not ours," a president of a general contractor spits out.

As one understands from this statement, there is no change at all in the real part of the industry's sense of crisis that it shows in reform of the bidding system.

13 September—Nagano Construction, which has its main office in Funabashi, Chiba, filed an administrative suit against the city. The incident's origin was the discovery of a suspected *dango* right before bidding on a city construction project contract in May 1988. In spite of Nagano Construction's being a designated company, it requested withdrawal from the bidding. Afterwards, in the process of an investigation on suspicion of *dango*, trouble surfaced. Nagano henceforth would not be called upon for the city's construction project bids for over two years. In reality, it is a halt in designation. In response, President Sadaharu Nagano filed suit requesting restoration of his reputation and compensation for damages.

"The city's excuse is that it can't do business with a company with which it has no relationship of trust, it is clear they are ostracizing us for withdrawing from the bidding. Anyway the trend is strong in the construction industry not to go against the tide. If this is not corrected, Japan's construction industry will never change," President Nagano threatens. In any event, President Nagano's true meaning is that the construction industry's *dango* system is not simply a problem of its members.

In the construction industry, widespread excessive competition and a dumping system of undertaking money-losing orders are also problems. "Subtracting such direct costs as labor from sales, the rough profit rate at most is about 8 percent even for private construction projects. It is said that construction industry participants are involved with *dango* and earning 20 percent, but there are next to no companies—even among the leading ones—carrying work with rough profits of 20 percent," according to President Moriji Toda of Toda Construction.

"Slipshod Accounting" Not Understood

Nikkenren's 54 companies earned a record turnover of 18.28 trillion yen in 1989, but the turnover total profit rate of 8.86 percent is only a marginal 0.25 point improvement over 1985. Even though it is said that business performance is good, the leading companies turnover operating profit rate is barely 4 percent. As seen in the example of the capital's government buildings construction projects, the companies are taking the work even while knowing it will put them in the red and making do with filling the gap with other projects. "It will not always be acceptable to do this stupid kind of work, but...." Although Nitto Construction Chairman Ishizawa reflects thus, he is unable to stop.

Comparing the management of construction companies in Japan and the United States, Japan's are generally low in both profitability and financial setup. The slipshod accounting structure of "taking work even at a loss," which is deeply engrained in Japan's construction industry, probably is not understood by U.S. enterprises.

The United States, in the Japan-U.S. construction *dango* review begun in May, thrust new demands for opening [the market] not limited to specific large-scale projects but expanded to all public works. "By my definition, it can't be said that Japan's construction market opening has gone far enough," criticized United States Trade Representative Hills at a Los Angeles press conference in early September.

Why is it that the arguments of Japan and the United States do not mesh? "Japan puts great emphasis on equality of results as seen in the distribution of government and public construction works. In contrast, the United States persists in emphasizing equality of opportunity and the process. Therein lies a great difference of opinion." So speaks Tobishima Director Kunio Maeda, an expert on the situation in the U.S. construction market who sounded the alarm before the construction friction surfaced. In this way, the arguments of Japan and the United States, no matter how many goverment-to-government negotiations pile up, run along parallel lines. Effectively, there will be no resolution of the problem without even greater foreign pressure.

Well, what should be done? At the least, even if restrictions are added to the reform proposals entered into the "Construction White Paper," if they cultivate in the industry a spirit of fair play based upon the principles of competition, it probably should be improved in that direction. For example, even for the JV system, if it gives birth to the original meaning of abandoning the coddling and advancing technical upgrading, it is expected that it would be all right for those tendering orders not to designate everything but to leave some things to the initiative of the enterprises.

Is There Resolve for the Construction Ministry Partition?

Now, what is being asked of Japan's construction industry are fair trading and contract rules that will pass internationally. Those are something distinct from "fair" in the Japanese sense. The result of reform, even if there are casualties among the 520,000 industry workers nationwide, "is the cost of fair play," according to Mr. Maeda. Now, decisive decisions and leadership are being demanded of the industry by the MOC. If the protection of small-to-medium and small-scale enterprises were

somehow necessary, isn't it that it would be all right to apply subsidies under a separate framework?

What is most difficult in reform is the tangle of politics that the construction industry carries. "The authorities have great influence over the industry, but they are weak before the politicians, who are weak before [the industry's] votes." Such is the design of the "three weak fawns." The construction industry is a typical example. There, privileges and graft are overgrown. Even speaking of mondernization and construction improvement, such words tend to end as platitudes given only lip service. As long as the scalpel is not taken to the design, the break up of the *dango* structure will end up as a camouflaged break up; lurking underground, they would probably strengthen their secrecy more and more. The modernization of the construction industry will not move ahead apart from structural improvement of the three-headed body of government, bureaucracy, and private industry."

If so, it is probably impossible for the MOC alone to promote structural improvement. Until the presentation of the "Construction White Paper," it made some progress under the direction of the industry's leading companies, but the real test starts now. In order not to repeat the set pattern of "agreement on the total argument, opposition to the particulars," the simple power to make arrangements alone will not do.

The MOC is a policy government office and—at the same time—a huge institution that tenders orders. "Until now, its character as a government office that tenders orders has been in the forefront," according to Shimizu Chairman Yoshino. There has been created in its structure, the potential to be easily swayed by the will of *zoku* dietmen in the distribution of its budget. If the aim is to be a true policy government office, a bold conception of a division of the MOC turning on moving its authority to tender orders to a separate institution is necessary. At a minimum, if there is not such a decisive resolve, the modernization of the construction industry will probably not advance.

[Box p 17] Teruzo Yoshino, chairman, Construction Reform Investigation Committee: "Many Odd Aspects If Seen From Foreign Countries"

At at time when society takes a dim view of the *dango* problem and such, I have come to agreements in the industry time and again: "Let's put a stop to this." However, the contents of technology differ; amidst the advance of internationalization, it has become a period in which it will not do simply to say things. It is not only the structure of bidding. This is a time we should be revising our thinking thoroughly about—and improving—the industry's structure, and the state of the construction industry itself.

It won't do if each company doesn't get the work corresponding to its strength if its makes the pitch with all its might, but the present state of the joint venture format is not always that way. There are various aspects thought to be strange if seen from foreign countries, such as 10 and even 20 companies entering into the bidding together. It is a large industry that handles 70 trillion yen of work, so there are some people who say that, "The way we've done things up until now is the best." But with the old structure, the construction industry does not have high ratings. If we are to change to a new way of doing things, troubles will probably emerge to some extent, but we will be tackling them positively, step by step.

[Box, p 17] Lower House Dietman Makoto Koga, chairman, LDP Construction Division: "We Should Continue To Keep a Fair Distribution"

In the midst of the advance of internationalization, how to advance the construction industry's modernization is an important administrative topic. As seen in words such as "*dango*" or "3K," the construction industry's image is not good. Recently, the problem has also been emerging of a breakdown in bidding on public works. Considering where the roots of these problems lie, I think that the government offices must quickly equalize the tendering of orders and their execution.

The industry posture of actively tackling liberalization of the bidding system is fine, but are all sectors—from the foremost leading companies to the small-to-medium and small-scale ones able, or not, to go in that direction? The construction industry has a large influence on regional economies. As the gap between enterprises is also large, it is necessary to examine this carefully. It will not do to have a handful of leading companies push this through. Basically, we shoud keep the structure we have had until now of public works orders tendered—distributing work fairly without favoring some industry participants. Of course, it will not do to neglect management efforts to improve the corporations and technology.

[Box, p 18] Fumio Hasegawa, visiting assistant professor, Tokyo University Advanced Science & Technology Research Center: "Erect a Structure of Tendering Orders Under the Prime Minister's Direct Control"

At the time called the winter period, the sense of crisis was strong in the industry. Each construction company competed to introduce TQC [total quality control], etc. With the unexpected boom, the companies focused their efforts solely on handling the orders they saw before them; concerning their structure, things were right back where they started from. For the purpose of corporate image alone, each company is making its own logo, changing its work ethic, and being earnest in improving its image, but there is the feeling of being excessively adrift.

The MOC, differing from the Ministry of International Trade and Industry, is a policy government office and—at the same time—a huge institution dispensing money and orders. The construction industry is one that subcontracts, so even if one can't go as far as to say that there exists a top-bottom relationship betweem the MOC and the construction industry, it is difficult for it to

become an equal relationship as with other industries [and their bureaucratic counterparts]. Over the next 10 years, 430 trillion yen of public works projects will be undertaken, but in order to advance at the same time the construction industry's modernization and the priority investment toward the fields related to living standards, the construction industry itself should keep on making proposals in the form of manufactured orders. Also, on the bid acceptance side, it would be good to consider concentrating the authority not under the ministries and agencies but in a structure under the direct control of the prime minister. [Boxed item p 18 omitted]

[Box, p 20] Masanori Suzuki, director general, MOC Bureau of Economic Affairs: "We Cannot Destroy Designated Competitive Bidding"

I think that we should seriously respond to the demands from the industry for improvement of bidding and contract systems. I would like to examine seriously concrete ways to move ahead together with the industry in a roundtable discussion. In this type of forum, the voices of the leading companies tend to be loud, but I intend to take into consideration fully the position of the small and medium companies as well.

We should probably also examine making more use of private contracts to be able to put to good use the corporation's technical strengths and know-how. Considering also our official duties on the order-tendering side, we absolutely cannot destroy the present base of designated competitive bidding. Whether or not we can convince the United States on that point I don't know, but even in England the base is designated bidding. The U.S. way is not an absolute.

Structural improvement is a policy topic of the utmost importance. We are taking various measures necessary for the equalization of orders tendered, the exclusion of unfit industry participants, etc. Will structural improvements advance or not making all 520,000 construction industry participants the object of administration? This is certainly a difficult issue. In any event, the basis is to develop enterprises excellent in technology and management.

[Box, p 20] Shogo Itoda, director general, Fair Trade Commission Bureau of Economic Affairs

Recently, dissolutions of the construction industry's friendship organizations have come, one after another, but it won't do to think facilely that all the *dango* problems are solved with the dissolutions of the structures. The issue of actual conditions is critical. I think that bidding *dango* is a violation of the antimonopoly law and one that can be the object of an FTC criminal indictment. If there is a violation, it would be natural to apply the law rigorously and eliminate it. In the construction industry under the bidding system presently in effect, there are voices saying that *dango* must continue, but that is the logic of industry participants who have ignored the position of the taxpayers. It is not an excuse for violations. If there are problems in the form of procurement, we should consider that separately.

As seen clearly up close in the structural talks, international harmony is now being demanded of Japan's construction industry. The important viewpoint is the antimonopoly law. I think that the consciousness of the corporate brass is rising, but efforts to make it penetrate to the far ends of the regions, to the branch offices, businesses, and such are important.